



Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division

[Islamabad]

Before Rashid Sadiq, Executive Director

Order

In the matter of

M/S F.R. MERCHANT & CO., CHARTERED ACCOUNTANTS

[UNDER SUB-SECTION (1) OF SECTION 260 READ WITH SECTION 255 AND SECTION 476 OF THE COMPANIES ORDINANCE, 1984]

Number and date of notice	EMD/233/191/2002 dated November 13, 2002
Date of final hearing	April 09, 2003
Present	Mr. Zafaruddin Siddiqui (Authorized Representative)
Date of Order	June 27, 2003

This Order shall dispose of the show cause proceedings initiated against M/S F.R. Merchant & Co. Chartered Accountants under Section 260 of the Companies Ordinance, 1984 (the “Ordinance”).

2. M/s F.R. Merchant & Co. Chartered Accountants is a partnership firm and the partnership comprises of Mr. Fida Hussain R. Merchant and Mr. Fakhar uddin Yousafali. Both of them are Fellow members of the Institute of Chartered Accountants of Pakistan (the “ICAP”) and were registered with the ICAP on December 14, 1961 and July 01, 1961 under Registration Numbers 177 and 135 respectively. The firm has offices in Lahore and Karachi.



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3. The relevant facts for the disposal of this case, briefly stated, are that M/S F.R Merchant & Co., Chartered Accountants were appointed as Auditors of M/S Beema Pakistan Limited (the “Company”) in its Annual General Meeting held on June 30, 2001 to hold office from the conclusion of the said meeting until the conclusion of next Annual General Meeting. They have audited the accounts and books of accounts of the Company for the year ended December 31, 2001 and have issued audit report to the members signed on June 08, 2002.

4. The examination of the annual accounts of the Company for the year ended December 31, 2001 (the “Accounts”) received by the Commission under Section 233 of the Ordinance along with the directors and auditors report was conducted in order to determine, among other things, as to whether the Auditors’ Report pertaining to the aforesaid financial year has been made in conformity with the requirements of Section 255 of the Ordinance, is otherwise true, contained no statement, which is materially false and that there is no omission of material facts about the affairs of the Company. It was noticed from the published accounts and other information available on record that:

- i) The Company had failed to obtain the Certificate of Registration from the Commission as required under Sub-section (1) Section 6 of the Insurance Ordinance, 2000 and, therefore, is not authorized to carry on the business of insurance.
- ii) The Board of Directors rescinded the allotment of shares made to Mr. Hameedullah, Ex-Chief Executive of the Company. These shares were subsequently re-issued and allotted to Mr. Shahnawaz Agha, present Chief Executive of the Company. The consideration for the aforesaid allotment amounting to Rs.15.773 million made to Mr. Shahnawaz Agha and that for advance against right issue of shares amounting to Rs.45.077 million was in



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the form of property which were not mutated and transferred in the name of the Company till the date of the signing of the auditors' report. The entire process of initial allotment without consideration, rescinding of the same and re-allotment were, *prima facie*, in violation of the requirements of Section 86 of the Ordinance.

iii) The Company has also not followed the following requirements of the International Accounting Standards (IAS) and Fourth Schedule to the Ordinance in preparation of the financial statements for the year ended December 31, 2001:

- “Deferred Revenue Expenses” of Rupees 1,717,682 have been written off during the year as prior period item in the Accounts in contravention to the accounting policy given in notes to the accounts, which states that the deferred expenses are to be amortized in three years. Further, the deferred revenue expenses included expenses in contravention of items mentioned in Para 5 (B) of Part II of the Fourth Schedule to the Ordinance.
- Disclosure of the number of employees as per Para 102(d) of IAS 1 (Presentation of Financial Statements).
- Disclosure as per the requirement of Para 11 of IAS 1 (Presentation Of Financial Statements).
- Disclosure of provisions for diminution in value of investments as requirements of paragraph 3 (F) of Part II of the Fourth Schedule to the Ordinance and Generally Accepted Accounting Practices.
- The description of the nature of the Company's operations as per the requirement of Para 102 (b) of IAS 1 (Presentation of Financial Statements).
- Accounting policies with respect to current and deferred taxation and estimated liability in respect to outstanding claims.



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5. It was also noticed from the perusal of the record that FORM III dated March 31, 2002 submitted by the Company to the Registrar of the Joint Stock Companies, Company Registration Office, Karachi under Sub-section (1) of Section 73 of the Ordinance that the Company has allotted 134,766,800 ordinary shares of Rs10/- each for consideration in kind. These shares worth 1.135 billion were issued without following the requirements of Section 86 of the Ordinance.

6. In view of the aforesaid deficiencies and irregularities, the auditors, report dated June 08, 2002 attached to the aforesaid Accounts of the Company was perused and it was transpired that the auditors have failed to modify their opinion to bring the aforesaid material facts about affairs of the Company to the notice of its members. The auditors have issued unqualified reports in the past also and have never raised any concern about allotment of shares without any consideration. The auditors' report was also silent on the fact that the Company was conducting illegal business. In fact instead of bringing these violations to notice of the members, the auditors have opined that the Balance Sheet, Fire, Marine, Motor and Miscellaneous Business Revenue Accounts, Profit and loss account, Profit and Loss Appropriation Account, Cash Flow Statement and Statement of Changes in Equity, together with the notes thereon have been drawn up in conformity with the approved accounting standards as applicable in Pakistan and the information required by the Insurance Ordinance 2000. They have further represented that the audit was conducted in accordance with the Auditing standards as applicable in Pakistan.

7. In view of the above, the Enforcement and Monitoring Division felt concerned about the quality of audit of the Company conducted by the Auditors



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and the reports made on the Accounts. This appeared to be a case where the Auditor has *prima facie* failed to report in conformity with the requirements of Section 255 and the report was otherwise untrue and contained statements and representations, which were materially incorrect.

8. Consequently, a notice dated November 13, 2002 was issued to the partners of M/S F. R Merchant & Co., Chartered Accountants to show cause as to why action may not be taken against them for the contraventions of the mandatory provisions of law. Mr. Fakharuddin Yousafali, and Mr. Fida Hussain R. Merchant replied to the notices separately through letters dated December 10, 2002 and December 20, 2002 respectively. Mr. Fakharuddin Yousafali, the partner incharge of the Lahore office, in his reply, stated that he is the partner at the Lahore office whereas the audit of the Company was carried out by Karachi office, where Mr. Fida Hussain R. Merchant is the Principal. He also added that he has nothing to do with the firm “F.R. Merchant & Co., Karachi” and pleaded that the notice against him may be withdrawn. Thereafter, in order to provide an opportunity to the auditors of personal hearing, the case was fixed on April 09, 2003 on which date Mr. Zaffarullah Siddiqui appeared on behalf of Mr. Fida Hussain R. Merchant and made his submissions on his behalf. Mr. Zaffarullah Siddiqui confirmed that Mr. Fida Hussain R. Merchant was the engagement partner for the audit of the Company and had signed the audit report on the Accounts and assumed full responsibility in this regard.

9. In the written submissions as well at the time of hearing of this case, some of the defaults were admitted while the auditors contested others. Mr. Zaffarullah Siddiqui admitted that there was carelessness on the part of auditors while making report in terms of Section 255 of the Ordinance. He assured that these defaults would not be repeated in future. I have heard Mr. Zafarullah



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Siddiqui and have also gone through his submissions and the relevant provisions of law and the material placed on record. My views on each of the issue are as under:

- i) It was contended that the Company published the Accounts prior to its approval by the Board of Directors and the auditors had refused to sign the published accounts as these contained various mistakes and deficiencies. It was also submitted that the auditors had taken up this matter with the Company vide their letter dated June 06, 2002. I have perused this letter in which the Company was informed that there were many mistakes in the printed accounts. After two days i.e, on June 08, 2002, the auditors signed their report. It is thus clear that the Company printed the accounts before the signing of the report by the auditors and these were also circulated to the shareholders, the Registrar, stock exchanges and the Commission. In my view the auditors have failed to follow the procedure as required by Auditing Standard 560 (subsequent Events) to ensure that the correct accounts and the reports are circulated to the shareholders and the regulatory bodies.
- ii) It was submitted that the report signed by the auditors included an emphasis paragraph, which highlighted the fact that the Company has filed an application for renewal of registration under the Insurance Ordinance, 2000. The Company, however, failed to publish the correct audit report. This issue was taken up with the Company vide letter dated June 06, 2002 The argument that the auditors do not own the accounts published by the Company along with the auditors report thereon as these are different from accounts signed by them is ironical because of the reason that the auditors have failed to bring this fact to the knowledge of the Commission or the users of the financial statements. They have failed to proceed in accordance with the requirements of Auditing Standard 560 (Subsequent Events). It has been noted that there was a considerable period of time from the date of the auditor's report i.e June 08, 2002 and the Annual General Meeting, which was held on June 29, 2002. The auditor could have informed the regulatory authorities and the shareholders in the Annual General Meeting about the discrepancies



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contained in the published copies of the audited accounts. The fact that the auditors had informed the management about the mistakes/deficiencies contained in the printed accounts does not absolve the auditor from his responsibilities. I have looked at this issue at length and have noted with concern that neither the Company nor the auditors have taken timely action to inform the users of the financial statements about this major irregularity. In this regard, I have noticed that the Annual General Meeting of the Company was held on June 29, 2002 for which the Company issued a notice of meeting on June 08, 2002, the date of signing of the audit report. The auditors have pointed out the irregularity to the Company vide their letter dated June 06, 2002. The signing of report just after two days of raising the objection and that too without ensuring the circulation of the correct accounts and reports to the shareholders and the regulatory bodies in itself indicates that the auditors has performed their duties too indulgently. At this stage, I would like to refer the provisions of Sub-section (6) of Section 255 of the Ordinance, which provides that in the case of a listed company, the auditors or a person authorized by him in writing SHALL be present in the general meeting in which the balance sheet and profit and loss account and the auditors' report are to be discussed. Moreover, the provisions of Section 256 of the Ordinance, requires that the auditors' report shall be read before the company in general meeting and shall be open to inspection by any member of the company. The auditors' report is also required to be sent to the shareholders 21 days before AGM date and a copy of the report is also required to be kept at the registered office of the company for inspection of the members of the company during a period of at least 21 days before the meeting as per requirement of Section 233 of the Ordinance. It was the responsibility of the auditors to have taken up this matter with the Company before AGM to ensure the circulation of the correct report to the shareholders and presentation of the same before the shareholders at the time of the meeting. If Company did not take immediate action at that time he should have informed this irregularity to the Commission. This, however, was not done. In my view, both the Company and its auditors are responsible for this serious irregularity. Failing to take the required action in this case, the auditor has gone against the



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basic principal of Code of Ethics i.e. *Due Care and Timeliness*, which an auditor has to follow to achieve the objectives of chartered accountancy profession. I have also perused the letter dated June 06, 2002 It talked about only the mistakes in the Accounts and not the incorrect printing of audit report. I have also noticed that initialed accounts released by the auditors to the Company did not contained any qualification regarding Registration Certificate and even the Accounts did not contained any statement on this issue. This is further strengthened from the fact that the Inspector namely Mr. Mohammad Tariq, FCA appointed by the Commission under Section 265 of the Ordinance in his report to the Commission has reported that the audit report circulated to the members was not even on the prescribed format. Further audit report circulated to the members was not even qualified with regard to dividend and registration issue. In my views, it was the duty of the auditors to have made his report in accordance with the guidelines provided in Auditing standard 570 (Going Concern) as there was significant uncertainty about the future of the Company in view of the non-registration of the Company under the Insurance Ordinance, 2000 and the Company was not in position to transact the business of insurance in Pakistan and the business being undertaken was in violation of the insurance law.

- iii) As regards to other deficiencies and irregularities, Mr. Zafarullah Siddiqui either admitted the defaults or has not been able to give any satisfactory reply. I, therefore, do not consider it necessary to deliberate on these issues.

10. Before concluding the issue it would be beneficial to understand the spirit of law. The Ordinance laid down provisions regarding several matters to be followed by the company in regard to the preparation of the accounts. The International Accounting Standards have been adopted to improve the quality of the financial statements and to improve increased degree of comparability. It is the responsibility of Directors to ensure that these provisions of law are followed in letter and spirit. At the same time, it is the duty of the Auditor to bring to the notice of the members the major breaches observed in the financial statements. The International Accounting Standards and Auditing Standards



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establish standards, which must be followed by the Auditors to ensure that financial statements are prepared in accordance with the Generally Accepted Accounting Principles and that the auditors carry out their responsibilities in accordance with the Generally Accepted Auditing Standards.

11. The shareholders are the ultimate entity to whom the auditors are responsible and are required to give a report on the accounts and books of account after conducting the audit in accordance with the prescribed procedures and requirements of the Ordinance and Standards. If they found any irregularity, they are required to issue a modified report, if the said irregularity is material to the accounts. They must keep this fact in mind while auditing the books of account and reporting thereon. They must also realize their true role and restrain themselves from performing their duties indulgently.

12. The auditors are required to conduct audit in accordance with the auditing standards and they should take into consideration such issues while reporting on the annual accounts of companies. It is clear from the above discussion that the auditors had failed to perform his statutory obligations by not communicating the discrepancies noted in the accounts and the auditors report published by the Company. It was also incumbent on the Auditor to have drawn attention to the members of the Company towards the non-compliances/contraventions of various provisions of law in his Audit Report. In the circumstances, it is clear that the Auditor has failed to perform his duties with reasonable degree of care and skill.

13. As the Auditor has admitted the defaults and has not been able to give any justifiable argument for the same, therefore, I consider it a deliberate act which is certainly more than mere omission and default on the part of Mr. Fida



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Hussain R. Merchant who was under legal obligation to perform his duties, in the course of audit of Accounts of the Company and reporting thereon, in accordance with the provisions of the Ordinance, International Accounting Standards and Auditing Standards. Mr. Fida Hussain R. Merchant has, therefore, made himself liable for punishment under Sub-section (1) of Section 260 of the Ordinance.

14. For the reasons stated above, I impose a fine of Rs. 2,000/- (Rupees two thousand) under Sub-section (1) of Section 260 of the Ordinance on Mr. Fida Hussain R. Merchant. As has already been discussed earlier, Mr. Fida Hussain R. Merchant has assumed sole responsibility of the audit of the Company, therefore, no fine is imposed on Mr. Fakhar uddin Yousafali.

15. Mr. Fida Hussain R. Merchant is directed to deposit the above stated fine in the Bank Account of Securities and Exchange Commission of Pakistan maintained with Habib Bank Limited within 30 days of the date of this Order and furnish a receipted challan to the Securities and Exchange Commission of Pakistan.

16. A copy of this Order may also be sent to President, ICAP for his information and necessary action in accordance with the provisions of the Chartered Accountants Ordinance, 1961.

Rashid Sadiq

Executive Director (Enforcement & Monitoring)

Announced
June 27, 2003
ISLAMABAD